

Message Text

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ACTION SS-14

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FRB-01 SSO-00 EB-03 /034 W

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FM AMEMBASSY LONDON

TO SECSTATE WASHDC IMMEDIATE 7238

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 17647

LIMDIS WITH DISTIRUBITON FOR S, D, E, P, EB, EUR, S/P,
TREASURY, NSC, FRB ONLY

E.O. LL652: GDS

TAGS: EFIN, UK

SUBJECT: SITUATION REPORT" NOVEMBER 3

REF: A. STATE 267L68 B. LONDON L7574

1. HEALEY MEETS WITH LABOR ECONOMIC COMMITTEE; SPEAKS
OF CUTTING PSBR. CHANCELLOR HEALEY, RESPONDING TO
REQUESTS FROM BOTH THE RIGHT-WING MANIFESTO AND LEFT-
WING TRIBUNE GROUPS, MET NOVEMBER 2 WITH BACKBENCH
LABOR MPS TO DISCUSS CURRENT ECONOMIC SITUATION.
ACCORDING TO TWO MPS WHO ATTENDED THE MEETING (LESS
DETAILED ACCOUNTS APPEAR IN TODAY'S PRESS), HEALEY
FIRST LISTENED TO BOTH GROUPS OUTLINE THEIR ACTION
RECOMMENDATIONS, OBSERVED THERE WAS CONSIDERABLE COMMON
GROUND AND REVIEWED HIS THINKING. HE TOLD THEM
THAT THE GOVERNMENT DESIRES TO WORK OUT AN ARRANGEMENT
TO FUND STERLING BALANCES, AND SAID, IN AN ASIDE, THAT
IT WOULD BE NICE TO MAKE AN ANNOUNCEMENT ON THE BALANCES
WHEN THE IMF DRAWING IS CONFIRMED. HEALEY, OUR SOURCES
SAY, CONFIRMED REPORTS THAT TREASURY IS CURRENTLY WORK-
ING ON THIS QUESTION, BUT DID NOT DISCLOSE ANY DETAILS.
HE GAVE A CLEAR INDICATION THAT HE WILL TAKE ACTION TO
REDUCE THE PSBR "WITHIN THE NEXT FEW WEEKS" -- OUR PLP
SOURCES EXPECT TO SEE NEW MEASURES ANNOUNCED IN THE
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FIRST WEEK OF THE NEXT PARLIAMENT (I.E. NOVEMBER 29-

DECEMBER 3). THRUST OF HEALEY'S REMARKS, ACCORDING TO OUR SOURCES, WAS THAT VAT AND EXCISE TAXES ARE LIKELY TO BE INCREASED AND MAY BE ACCOMPANIED BY SOME REDUCTIONS IN PUBLIC SPENDING. TAX INCREASES WILL BE IMPOSED THROUGH USE OF THE "REGULATOR" DEVICE NORMALLY USED FOR FINE TUNING THE ECONOMY, THUS OBTAINING THE NEED FOR LEGISLATION. CONSERVATIVES HAVE REPORTEDLY AGREED TO THIS PROCEDURE. ONE RIGHT-WING LABOR SOURCE, WHO ATTENDED THE MEETING, STRESSED THAT GOVERNMENT'S POLITICAL MARGINS ARE EXTREMELY THIN WHEN IT COMES TO SPENDING CUTS, BUT THAT EVEN SOME HARD-LINE TRIBUNITES APPEARED TO AGREE THAT NOT ALL PUBLIC SPENDING WAS NECESSARILY GOOD. HEALEY WAS SCORNFUL OF THE LEFT'S DEMANDS FOR WIDESPREAD IMPORT CONTROLS. HE ALSO ADDRESSED IMPORT DEPOSIT SCHEME URGED BY MANIFESTO GROUP, INDICATING HIS STRONG OPPOSITION BUT NOT ENTIRELY RULING OUT, SUCH MEASURES. THE MEETING, IN OUR JUDGMENT, WAS PART OF THE PROCESS OF SOFTENING UP LABOR BACKBENCHERS. AND FROM OUR ACCOUNTS IT APPEARS TO HAVE BEEN A SUCCESS. OUR SOURCES REPORT THAT MEETING WAS MARKED BY STRONG SENSE OF UNITY AND TOTAL ABSENCE OF RANCOR, THOUGH OF COURSE THERE WERE SHARP DIFFERENCES OF OPINION AS TO WHAT MEASURES ARE NEEDED.

2. STERLING BALANCES. WE UNDERSTAND THAT THE COMMONS "EARLY DAY MOTION" ON STERLING BALANCES REFERRED TO IN YESTERDAY'S SITREP HAS NOW BEEN SIGNED BY VIRTUALLY ALL LABOR BACKBENCHERS.

3. LONDON TIMES THIS MORNING GAVE PAGE ONE COVERAGE TO SECRETARY SIMON'S WASHINGTON POST INTERVIEW. HIGHLIGHTING STATEMENT THAT U.S. DID NOT WANT THE CONDITIONS IMPOSED SO TOUGH AS "TO MAKE THEIR POLITICAL LIFE IMPOSSIBLE."

4. UK RESERVES IN OCTOBER FELL BY 455 MILLION. TO \$4.7 BILLION. A TREASURY SPOKESMAN NOTED THAT THERE HAD BEEN NO DRAWING UPON THE \$5.3 BILLION STANDBY CREDIT DURING THE MONTH.

5. CASH LIMITS. AS IF IN RESPONSE TO PUBLIC SECTOR
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UNION COMPLAINTS ABOUT THE NEGATIVE IMPACT OF THE CASH LIMITS SYSTEM ON PUBLIC SPENDING, JOEL BARNETT, CHIEF SECRETARY OF THE TREASURY, IN A WRITTEN ANSWER TO A PARLIAMENTARY QUESTION, SPOKE OF H.M. GOVERNMENT'S INTENTION GENERALLY TO ADHERE TO THE ESTABLISHED FY 76 CASH LIMITS. BEFORE CONSIDERING EXCEPTIONS, BARNETT SAID THAT SPENDING DEPARTMENTS WOULD HAVE TO USE "EVERY POSSIBLE MEANS TO ABSORB THE EXTRA EXPENDITURE". THE

STRAINS IMPOSED WILL NOT BE AS HIGH AS ANTICIPATED BE-

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LIMDIS

CAUSE GOVERNMENT SPENDING CONTAINS A HIGH WAGE COST ELEMENT (OVER 65 PERCENT). SINCE WAGE INCREASES HAVE BEEN HELD DOWN BY INCOMES POLICY, THE STRESSES WILL BE FELT MAINLY IN AREAS OF SPENDING WITH HIGH IMPORT CONTENT. ONE EXAMPLE IS THE COST OF THE BRITISH ARMY ON THE RHINE WHICH HAS INCREASED SHARPLY IN STERLING TERMS AS THE POUND DROPPED AGAINST THE DEUTSCHEMARK. WHILE SOME OF THE INCREASE MAY BE OFFSET BY LOWER DOMESTIC SPENDING ON DEFENSE. IT IS LIKELY THAT A PARTIAL EXCEPTION TO THE CASH LIMIT WILL BE MADE FOR THE BAOR. BRITISH DEFENSE SECRETARY FRED MULLEY REPORTEDLY RAISED ON NOVEMBER 2 THE PROBLEM OF THE COSTS OF THE BAOR ON A VISIT TO THE FRB. COMMENTING IN AN EDITORIAL, THE FINANCIAL TIMES SAID THAT A VIRTUE SHOULD BE MADE OF NECESSITY AND A REVIEW SHOULD BE MADE OF THE ENTIRE EUROPEAN DEFENSE QUESTION WITH A VIEW TOWARD A MORE EQUITABLE SHARING OF THE BURDEN. I.E., ONE THAT REFLECTS THE UK'S DIMINISHED ECONOMIC CAPABILITIES.

6. CBI SURVEY SHOWS WANING OPTIMISM. IN ITS QUARTERLY INDUSTRIAL TRENDS SURVEY THE CONFEDERATION OF BRITISH INDUSTRY (CBI) REPORTS THAT AN EROSION OF BUSINESS OPTIMISM HAS OCCURRED OVER THE PAST THREE MONTHS. IN

ADDITION, THE SURVEY REVEALED SIGNS OF AN END TO THE
IMPROVEMENT IN CORPORATE LIQUIDITY THAT HAS OCCURRED
OVER THE LAST 18 MONTHS. THIS COULD HAVE SERIOUS IMPLI-
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CATIONS FOR FUTURE LEVELS OF NEW INVESTMENT. IN FACT,
NEW INVESTMENT IN MANUFACTURING IN 1977 IS NOW EXPECTED
TO RISE BY 10-15 PERCENT COMPARED WITH 20-25 PERCENT IN
THE LAST SURVEY. ON A MORE POSITIVE NOTE. OTHER SURVEY
RESULTS CONTINUE TO INDICATE STRENGTH IN THE AREAS OF
EXPORTS AND OVERALL OUTPUT. GDP IS EXPECTED TO INCREASE
BY 3 PERCENT IN 1977 WHILE EXPORT VOLUME IS FORECAST
TO INCREASE BY 10 PERCENT WITH THE CURRENT ACCOUNT
SHOWING MARKED IMPROVEMENT AS THE IMPACT OF NORTH SEA
OIL IS FELT.

7. STERLING. CLOSED TUESDAY AT \$1.5930, UP SIXTY
BASIS POINTS. IT FELL THIS MORNING, STANDING AT \$1.5887/
94 AT 9:30 A.M.

8. EQUITY AND BOND MARKETS. TRADING IN EQUITIES WAS
THIN ON TUESDAY. PRICES GENERALLY RISING IN EARLY
TRADING TO FALL LATER IN THE DAY. THE FINANCIAL TIMES
INDEX OF 30 INDUSTRIAL STOCKS FELL 2.7 POINTS TO 283.6
AT THE CLOSE OF TRADING. THIS LEVELING ENDED A THREE-
DAY RALLY WHICH SAW THE INDEX RISE FROM AN OCTOBER 27
LOW OF 265.3. EQUITY PRICES EASED A BIT IN EARLY
WEDNESDAY TRADING. GILTS CONTINUED STEADY IN TUESDAY'S
TRADING, AND OPENED WITHOUT LARGE CHANGES ON WEDNESDAY.

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